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Panel remarks by Paul Saffert, Allianz AG

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It's amazing how much can really be said in ten minutes. Our next speaker is Paul Saffert from Allianz AG. He is the Project Leader for the implementation of Sarbanes-Oxley throughout the company and has been such since January 1 of 2004.

Paul Saffert: Good afternoon. As just announced, I've been involved with project leadership at Allianz for the 404 project since the beginning of 2004. What I'd like to do this afternoon is take you through where that project has been. We made a full dry run in the year 2004 and intend to be compliant completely in 2005. I'll talk a little bit about Allianz itself. Allianz is a very large company. It runs basically four segments; property and casualty insurance, life and health insurance, asset management and banking. It has about 160,000 employees, a trillion dollars in assets, about a hundred billion dollars of annual revenue. Those numbers are interesting but not really that relevant for SOX. The relevant number for SOX is that we do business in 70 countries and basically that creates an environment where we're implementing SOX in something approaching 50 companies, each of which are relatively stand-alone, have very little shared systems even at the entity level controls. These companies tend to have their own local jurisdiction sets of controls. So, the project got to be a very large one for us.

When we started out we set four goals for ourselves. The first goal was to be 404-compliant. That was the minimum goal that was required for me to keep my job. The second thing we wanted to do was to try to integrate SOX with our operational risk management. The two are very similar disciplines. We thought there'd be a big opportunity there to take advantage of the fact that we have one mandatory process and use that as a vehicle to roll out ORM to the rest of the Group. That was a little bit of a disappointment because really what happened is it worked during the early stages but then SOX sits on a different time track and it simply pulled away. It used the same resources ORM needed and so really we were coming back to try to get to ORM. Our third objective was to do a good job managing the project. We were going to spend a lot of money on this project, a lot more than the figures you've heard earlier today. We wanted to make sure we got something out of it and that we spent what we did spend well. Part of that was to put a limit on how much companies could spend on consultants. We did not allow any of our companies to spend more than 25% of their SOX budget on consultants because we wanted that expertise to stay in-house. Then, finally, the fourth objective for SOX; and to me the most important one, is if we could use this project and this process, to demonstrate that Allianz is a world-class organisation in terms of corporate governance, we think there's a huge competitive advantage there because we do business with a lot of people who make valued judgements and qualitative judgements about the company and if you have a reputation for being good at corporate governance, those people making those judgements, the regulators, the rating agencies, the analysts are going to give you the benefit of the doubt or give you a more favourable outcome than if you don't have that kind of reputation. So, we put that down as a very major goal for SOX for ourselves.

The way we were organised, we had 52 category one companies in our project mode for the dry run year. That means these companies basically had to go through stocks from top to bottom in the whole entity. We ended up with 5,000 documented processes and sub-processes, 17,000 key controls and the cost, that bottom number, is $70 million from inception of the project until the end of August. Now, that $70 million is a fully allocated cost basis. So, if I'm a person working in an underwriting unit someplace and I'm spending 20% of my time on SOX, that 20% of my salary, my benefits, my space allocation, any other overhead allocated to me, is going into that $70 million number. So, that makes this project a huge project from Allianz's standpoint. We run the project with a central project team of 11 fulltime employees. That's down to seven right now, and it will go down to six fairly shortly.

Now, here are some surprising numbers. These are the number of deficiencies. In the top part of the chart I've identified deficiencies and classified them based on the company in which they originate. So, we've got companies that might only have $100 million of revenue and they're obviously going to have a lower threshold for what's a significant deficiency than a company that might have $25 billion of revenue. In the lower part of the chart, I've there classified the deficiencies by the magnitude that we think the misstatement could occur. Now, 1,700 deficiencies is a huge number but the way we counted these is we took the inventory at June 30th of this year and even if the deficiency's been remediated, if it has not been retested, for example, there haven't been enough example cases to go through, it's still on this list. It doesn't come off the list until it's been both remediated and retested. Also, just over 60% deficiencies are lack of evidence. In other words, the control has actually been exercised and it's an effective control but that exercise has not been documented. So, that part of the retesting should be relatively straightforward to correct.

Someone got very fancy with these overheads. I think the point here is that if you have done any reading in this area, it's entity level controls that really count. That's really what brought Sarbanes-Oxley to this company. So, we're unable to exercise properly entity level controls including things like management override. Nonetheless, when you look at the way SOX has developed, we're spending most of our money on process level controls. So, you've got very much of an imbalance here as to where you're spending your money and where you're going to get your value. Hopefully, as the SEC and the PCAOB become a little more principles-oriented here, we can do a better job of focussing on the areas where you've got risk and exposure but right now that's not necessarily the case.

We've heard some talk today about principles-based versus rules-based. The standard number two is an extremely rule-based formula and that's driven a lot of cost, really, in the project. It's also caused the accounting firm to be very unforthcoming with advice. They were very concerned about what they were doing. They got themselves involved in checklist auditing. Now, the May 16th release moved a little bit further along that spectrum, away from rule-based more toward principles-based. Now, the difficulty that I see here is when you have a rules-based system the accountants, the lawyers and investment bankers get right into it and give you a road map how to get around those laws. Then, when you shift over to the principles side of the spectrum, we unfortunately seem to find out that there are a lot of people out there who don't have any and that's the difficulty as we go back and forth across the spectrum. Allianz is hoping that a more principles-based regime stays in because we think there's a lot of opportunity here in terms of scoping for next year's result. However, I would really like to see what happens on the PCAOB audits of the firms that should be released sometime within the eight weeks because if those audits show a very detailed rule-based orientation, then we're going to have to adjust what we think we can do on the scoping side.

Basically, we had controls in place, both process level and entity level controls. However, they were not particularly well documented and in the case of the entity level controls they were really not built into the fabric of the company. They were very people-dependent and so if you have the same individuals doing it over and over you're going to be fine but we've really brought a lot more formality into that. The changes we've made as a result of Sarbanes-Oxley – a couple around the audit committee having to do with auditor independence and how we deal with any reported errors in financial statements that might be coming in from whistleblowers or so on. We've introduced a special code of conduct for those people who are involved in the financial statement preparation, a little more focus on the financial statements to draw their attention to the things we think we want to make sure they're aware of. Finally, we've implemented disclosure committees in most of our larger companies which we think is going to be a big plus in terms of the reporting process.

Here are a couple of concerns going forward. I think just managing the project is going to take a lot of effort in controlling the cost and making sure that SOX and 404 is built into the fabric of your departments. If you don't do that you're going to have just an extra bubble of cost out on the side and you're not going to be getting any real advantage out of it. We have a lot of concern about the complexity of the accounting rules. Someone here this afternoon mentioned that about 40% of the errors that are coming in are basically human-related, lack of skills to apply accounting standards. That's a concern for a company as widespread as Allianz. The one that's not up here but should be here is end-user computing. That's a major concern, particularly in insurance companies where there's an awful of end-user computing used in some of the actuarial processes.

Going forward, what do we expect? We do see that our financial statement preparation process is improving. It's getting much more transparent, it's faster; there's more time for analysis. So, we think we are getting some value for that. I'm not going to tell you we're getting $70 million of value out of it. Finally, we do expect to go for this reputation for a high level of quality corporate governance and, I guess, really if you want a reputation for corporate governance you've got to be willing to go out and talk about it and that's really why I'm here today. Thanks for your time.